PRIVY COUNCIL REPORT

LIM FOO YONG SDN. BHD. v. COMPTROLLER-GENERAL OF INLAND REVENUE

[P.C. (Lord Bridge of Harwich, Lord Templeman, Lord Griffiths, Lord Ackner & Lord Oliver of Aylmerton) February 26 & March 20, 1986]

[Privy Council Appeal No. 42 of 1983]

Revenue Law – Sale of land and of shares – Whether trading receipts or realization of capital assets – Whether there was evidence before Special Commissioners upon which they could properly reach conclusion that the sum was a trading profit and taxable accordingly – Income Tax Ordinance, 1947, ss. 10(1)(a).

In this case the appellant had purchased five vacant lots upon which between 1957 and 1959 it caused to be erected a hotel known as Hotel Merlin. In 1959 the appellant caused to be incorporated a wholly owned subsidiary, Hotel Merlin Ltd. whose principal object was the carrying on of a hotel and restaurant business and in which it held 95,800 shares, being over 90% of the issued share capital. The hotel was leased to Hotel Merlin Ltd., which conducted the hotel business there for the next four years. The finance for the construction of the hotel was initially found by raising a loan from a bank but was subsequently met by a loan of $2,000,000 from the Employees Provident Fund on a security of a charge of the land.

On March 30, 1962 three separate documents were executed. By the first of these the appellant agreed to sell the Merlin Hotel and the land to the E.P.F. Board for a sum of $5,000,000. The agreement provided that the sum of $3,000,000 the balance due after discharging the amount due on the security of the charge to E.P.F. should be paid on completion. It also provided for the simultaneous execution of a lease back to the appellant of the hotel for ten years at the annual rent of $371,400 and of an agreement by the appellant to repurchase the property at the end of ten years at the original price of $5,000,000. The documents were executed and the sum of $2,622,510 which is included in the first of the additional assessments under challenge in this case was the profit represented by the difference between the total acquisition and construction cost of $2,377,490 and the agreed purchase price of $5,000,000.

In the following year it was decided to raise further capital to expand the hotel's activities and a new subsidiary company, Merlin Hotels Malaysia Ltd. (the Hotel Company) was formed. On July 6, 1963 an agreement was executed between the appellant and the hotel company whereby the appellant agreed to sell to the Hotel Company certain assets for a total consideration of $5,098,782. This included a sum of $4,201,000 for the assignment of the right to repurchase the hotel land. The total consideration was under the agreement to be satisfied by the issue of 5,098,782 shares of $1 each in the Hotel Company credited as fully paid up. The whole of the sum of $4,201,000 attributable to the benefit of the repurchase contract was treated as trading profit and included in the additional assessment for the year 1964.

There was also included in the additional assessment for 1964 two further sums. As part of the scheme for reconstruction the appellant exchanged the 98,800 shares of $10 each which it held in Hotel Merlin Ltd. for a further 1,482,000 shares of $1 each in the Hotel Company. This represented a premium on the shares exchanged of $494,000 over nominal value and the whole of this sum was treated by the Revenue as a trading profit and included in the assessment. Finally in the course of 1963 the appellant sold all but one thousand of the parcel of 1,482,000 shares which it had acquired to various members of the public at the average price of $1.20 per share thus making a profit of $288,332-62 which was also treated as a trading profit.

Thus the appellant was assessed to tax in respect of the sums of money that is (i) $2,622,510 (ii) $4,201,000 (iii) $494,000 and (iv) $288,332-62 which the Comptroller-General held to be profits from trade thereby attracting income tax under section 10(1)(a) of the Income Tax Ordinance, 1947. On appeal by the appellant, the Special Commissioners upheld the assessments but on further appeal to the High Court, Harun J. reversed the findings and order of the Special Commissioners. No reasons, oral or written was given by the learned Judge. Subsequently the Federal Court allowed the appeal from the order of Harun J. – see [1983] 1 M.L.J. 43. The appellants appealed.

On the appeal it was common ground that as the Special Commissioners had found in this case that the sums in question represented profits of a trade, the burden lies on the appellant to show that that decision was wrong in law; and since the question of whether a receipt is of a revenue or capital nature is one of fact and degree, this involved demonstrating that the true and only reasonable conclusion contradicted the conclusion at which the Special Commissioners arrived.

Held: (1) as regards the first of the relevant transactions, it seems entirely clear both from the nature of the transaction taken as a whole and from the Special Commissioners' findings of fact in relation to it, that it was a transaction which was designed to raise finance over a fixed period on a capital asset and their Lordships are unable to agree with the Special Commissioners that the mere fact that it took the form of a sale for a sum which, no doubt, equated with, or was less than, the value of the property but which exceeded the cost of acquisition automatically results in the excess falling to be treated as a taxable profit from trading. The whole tenor of the transaction indicates an intention on the part of the appellant to retain the asset, the hotel and the profit element in it, as a capital asset and to describe finance raised in this way, which in any event was subject to a liability to pay back exactly the same sum on a repurchase, to which the vendor was contractually bound from the inception, as a profit from trade is, in their Lordships's judgment, a misuse of language;

(2) turning to the reconstruction, the sums of $4,201,000 represented by the value of the repurchase agreement and the $494,000 representing the profit on the exchange of the appellants' holdings, the conclusion at which the Special Commissions arrived at was both inconsistent with their own finding as to the purpose for which the transaction was entered into and unsupported by evidence of any probative value that what had clearly started out as a capital asset had somehow become trading

stock which was disposed of by the appellant in the course of carrying on either a business of dealing in land or the business of carrying out a profit-making scheme;

(3) the final transaction giving rise to the profit of $288,332 was the sale by the appellant of 1,481,000 shares in the Hotel Company to friends and associates. The vast bulk of the shares issued on the reconstruction was retained by the appellant and on the face of it the sale of a minority holding arising from the disposition of a capital asset in the form of shares in a subsidiary company appears as no more than itself the disposition of a substituted capital asset;

(4) the judgment of the Federal Court simply follows and adopts the reasoning of the Special Commissioners. They held that there was evidence to justify the findings of the Special Commissioners. The Board was unable to agree with this, having regard to the reasoning upon which the decision of the Special Commissioners was based and to the inconsistencies of their findings. There was no evidence of probative value upon which the Commissioners could legitimately conclude that the transactions giving rise to the additional assessments were other than the realisation of capital assets. The conclusion reached was based upon fallacious reasoning and was, in any event, inconsistent with their own findings as to the purpose of the disposition. Their Lordships had very much in mind counsel's forceful submission that the statute places on the appellant the burden of demonstrating that the assessments were erroneous and that there was no express finding by the Commissioners that the hotel land was acquired and held as a capital asset nor any evidence that the appellant had expressly so resolved. That may be so, but the burden is no higher than that in any other civil proceeding and the facts found relating to the acquisition, development and holding of the hotel lands do not, in their Lordships' judgment, admit of any other reasonable conclusion than that they were acquired and held as capital assets. The Special Commissioners are, of course, as the Federal Court rightly observed, the judges of fact, but in finding the facts and drawing inferences of secondary fact from them, they must not misdirect themselves and they must draw conclusions from facts having probative value. In their Lordships' judgment, the Special Commissioners in this case both misdirected themselves by reaching conclusions inconsistent with primary facts found by them and drew inferences from matters which were of no probative value in supporting their conclusions.

Cases referred to:

(1) *Edwards* v. *Bairstow* [1956] A.C. 14.
(2) *Simmons* v. *I.R.C.* [1980] 1 W.L.R. 1196.
(3) *Californian Copper Syndicate* v. *Harris* (1904) 5 T.C. 159.
(4) *Craddock* v. *Zevo Finance Co. Ltd.* (1946) 27 T.C. 267.
(5) *Royal Insurance Co. Ltd.* v. *Stephen* (1928) 14 T.C. 22.

PRIVY COUNCIL APPEAL FROM MALAYSIA.

Stewart Bates Q.C. (*James Puthucheary* and *Stephen Allcock* with him) for the appellants.

D.C. Potter Q.C. (*K. Prosser* with him) for the respondent.

Cur. Adv. Vult.

Lord Oliver of Aylmerton (delivering the Judgment of the Board): This is an appeal from a judgment dated August 14, 1982 of the Federal Court of Malaysia (Raja Azlan Shah C.J., Salleh Abas F.J. and Abdoolcader J.) allowing an appeal by the respondent, the Comptroller-General of Inland Revenue, from an order made by Harun J. in the High Court on March 20, 1979 which had allowed the appellant's appeal by way of Case Stated by the Special Commissioners of Income Tax who had dismissed the appellant's appeal against two notices of additional assessment dated July 1, 1967 in respect of the years 1963 and 1964 respectively.

As regards the year 1963, the appellant challenged the inclusion in its income tax assessment of a sum of $2,622,510.00 representing the profit on the sale by the appellant of certain land forming the site of a hotel, which profit the revenue claimed to be of a revenue nature. As regards the year 1964, it challenged the inclusion of a sum of $4,201,000.00 representing the profit on the sale of the appellant's rights under a lease and a repurchase agreement, a sum of $494,000.00 representing its profit on the sale of shares in a subsidiary company to a public company, Merlin Hotels Malaysia Limited, and a sum of $288,332.00 representing the profit on the sale of shares in that company to members of the public.

Section 10(1)(a) of the Income Tax Ordinance, 1947, which was the provision in force at the time of the assessments challenged by the appellant, provided (so far as material) that:—

> "Income tax shall ... be payable ... upon the income of any person ... In respect of (a) gains or profits from any trade, business, profession or vocation, for whatever period of time such trade, business, profession or vocation may have been carried on or exercised."

It was the appellant's contention that the four sums in question were not trading receipts but the proceeds of the realisation of capital assets and the essential question raised on the appeal is whether the Federal Court was right in holding, as it did, that there was evidence before the Special Commissioners upon which they could properly reach the conclusion that each of the four sums was a trading profit and taxable accordingly.

The appellant, Lim Foo Yong Sendirian Berhad, is a private limited company incorporated on April 8, 1954 at the instance of Lim Foo Yong. It is a family company and its two directors are

Lim Foo Yong and his wife. It is unnecessary to refer in terms to the appellant's objects as set out in its Memorandum of Association. It is sufficient for present purposes to say that they include purchasing property for investment and, equally, the trafficking in real or personal property. It is also worth mentioning that the objects include the carrying on of the business of hotel, restaurant and cafe keepers and other similar objects. At the date of the appellant's incorporation, Lim Foo Yong was the owner of a small hotel called the Harlequin Hotel and of a number of plots of land which he had purchased with a view to its expansion. These were acquired by the appellant in 1955 and 1956 but were subsequently sold in 1958, 1959 and 1964. It is not disputed that the profits on these sales were taxed as trading profits, as were the compensation received from the compulsory purchase of two plots acquired in 1957 and the profit on the sale by the appellant of a shophouse which it had acquired from Lim Foo Yong in 1955.

The relevant history for the purposes of this appeal starts with the acquisition by the appellant in 1956 of five vacant lots upon which, between 1957 and 1959, it caused to be erected a hotel known as the Hotel Merlin. These lots are conveniently referred to as "the Merlin land". In 1959 the appellant caused to be incorporated a wholly owned subsidiary, Hotel Merlin Limited, whose principal object was the carrying on of a hotel and restaurant business and in which it held 98,800 shares, being over 90% of the issued share capital. The hotel was leased to Hotel Merlin Limited which conducted the hotel business there for the next four years. The finance for the construction of the hotel (the total cost of which, including the land, was $2,377,490.00) was initially found by raising a loan from a bank but subsequently met by a loan of $2,000,000.00 from Employees Provident Fund ("E.P.F.") on the security of a charge of the Merlin land.

Thus matters stood in 1962 when there took place the first transaction out of which this appeal arises. On March 30, 1962, three separate documents were executed, the parties in each case being the appellant and the E.P.F. Board (a body incorporated by Statute). By the first of these the appellant agreed to sell the Merlin Hotel and the Merlin land to the Board for a sum of $5,000,000.00. The agreement provided that the sum of $3,000,000.00, the balance due after discharging the amount outstanding on the security of the charge to E.P.F., should be paid on completion. It also provided for the simultaneous execution of a lease back to the appellant of the hotel of ten years at an annual rent of $371,400.00 and of an agreement by the appellant to repurchase the property at the end of ten years at the original purchase price of $5,000,000.00, the lease and repurchase agreements to be in the form of drafts scheduled to the sale agreement. Those documents were in fact duly executed and the sum of $2,622,510.00 which is included in the first of the additional assessments under challenge is the profit represented by the difference between the total acquisition and construction cost of $2,377,490.00 and the agreed purchase price of $5,000,000.00.

In the following year it was decided to raise further capital to expand the hotel's activities and a new subsidiary company, Merlin Hotels Malaysia Limited (conveniently referred to as "the Hotel Company") was formed on May 31, 1963. On July 6, 1963 an agreement was executed between the appellant and the Hotel Company whereby the appellant agreed to sell to the Hotel Company certain assets for a total consideration of $5,098,782.00. This was made up as follows:

Assignment of lease granted by E.P.F.	$ 1.00
Assignment of right to re-purchase the hotel land	$4,201,000.00
Furniture and fittings of Hotel Merlin	$ 600,000.00
54,142 shares of $5.00 each in the capital of Cameron Highlands Hotel Company (1959) Limited	$ 297,781.00

The total consideration was, under the agreement, to be satisfied by the issue of 5,098,782 shares of $1.00 each in the Hotel Company credited as fully paid up. No question appears to have been raised as regards the fixtures and fittings or the 54,142 shares in Cameron Highlands Hotel Company (1959) Limited, but the whole of the sum of $4,201,000.00 attributable to the benefit of the repurchase contract was treated as a trading profit and included in the additional assessment for the year 1964.

There were also included in the additional assessment for this year two further sums. As part of the scheme of reconstruction the appellant exchanged the 98,800 shares of $10.00 each which it held in Hotel Merlin Limited for a further 1,482,000 shares of $1.00 each in the Hotel Company. This represents a premium on the shares exchanged of $494,000.00 over nominal value and was, it appears, based upon a valuation of the shares by Peat Marwick Mitchell and Co. The whole of this sum was treated by the Revenue as a

trading profit and included in the assessment. The Hotel Company, which had been formed as a public company, achieved a quotation in August 1963 and thereafter its shares were dealt with publicly. Finally, in the course of 1963, the appellant sold all but one thousand of the parcel of 1,482,000 shares which it had acquired to various members of the public at an average price of $1.20 per share thus making a profit of $288,332.62 which was also treated as a trading profit. The remaining 5,099,782 shares were retained by the appellant.

The appellant appealed against the additional assessments to the Special Commissioners and it is appropriate, in this connection, to note that the procedure in revenue appeals in Malaysia follows, in general, the pattern of such appeals in the United Kingdom. Section 76(3) of the 1947 Ordinance (now re-enacted by paragraph 13 of the fifth Schedule to the Income Tax Act 1967) places upon the appellant taxpayer the onus of proving that the relevant assessment is excessive or erroneous, so that it is for the taxpayer to put before the Special Commissioners the facts which he claims lead to the conclusion that he has been wrongly assessed to tax. From the Special Commissioners appeal is by Case Stated on a point of law only to the High Court. Thus it is common ground that, the Special Commissioners having found in the instant case that the sums in question represent profits of a trade, the burden lies upon the appellant, following *Edwards* v. *Bairstow*[1] to show that that decision was wrong in law; and since the question of whether a receipt is of a revenue or capital nature is one of fact and degree, this involves demonstrating that the true and only reasonable conclusion contradicts the conclusion at which the Special Commissioners arrived.

It is thus necessary to examine, with some care, the facts which were found by the Special Commissioners and the inferences which they drew, but bearing in mind always the caution that it is not for an appellate tribunal to substitute for the findings of the Special Commissioners what it thinks it would have found had it been hearing the original appeal but to see whether there was before the Commissioners evidence upon which they could properly and reasonably reach the conclusion that they did reach and whether, having regard to the facts found, their conclusions were consistent and intelligible. It is, in this context, helpful to bear in mind – and this has a particular relevance having regard to some of the reasoning of the Special Commissioners – the following passage from the speech of Lord Wilberforce in *Simmons* v. *I.R.C.*[2] to which their Lordships were referred by Mr. Bates Q.C. for the appellant. At page 1199 Lord Wilberforce observed:–

> "One must ask, first, what the Commissioners were required or entitled to find. Trading requires an intention to trade: normally the question to be asked is whether this intention existed at the time of the acquisition of the asset. Was it acquired with the intention of disposing of it at a profit, or was it acquired as a permanent investment? Often it is necesssary to ask further questions: a permanent investment may be sold in order to acquire another investment thought to be more satisfactory; that does not involve an operation of trade, whether the first investment is sold at a profit or at a loss. Intentions may be changed. What was first an investment may be put into the trading stock – and, I suppose, vice versa. If findings of this kind are to be made precision is required, since a shift of an asset from one category to another will involve changes in the company's accounts, and, possibly, a liability to tax: see *Sharkey* v. *Wernher* [1956] A.C. 58. What I think is not possible is for an asset to be both trading stock and permanent investment at the same time, nor to possess an indeterminate status – neither trading stock nor permanent asset. It must be one or other, even though, and this seems to me legitimate and intelligible, the company, in whatever character it acquires the asset, may reserve an intention to change its character. To do so would, in fact, amount to little more than making explicit what is necessarily implicit in all commercial operations, namely that situations are open to review."

That was a case in which the majority of the House of Lords found that the conclusion of the Special Commissioners that certain assets acquired as investments were trading stock was plainly wrong. As Lord Salmon observed at page 1203, "an investment does not turn into trading stock because it is sold". That may seem to be almost a truism but is is Mr. Bates' submission that, when the reasoning of the Special Commissioners is examined, it can be seen that they simply assumed that because an asset has been disposed of at a profit, it follows that its disposition is part of what they called "a profit-making scheme" which necessarily has the effect of causing the asset to be treated as trading stock regardless of the character which it previously bore. It is, he submits, the only reasonable conclusion from the facts that the Merlin land was acquired by the appellant as an investment and although Mr. Potter Q.C., for the respondent, has emphasized that there is no finding by the Commissioners to this effect, there is equally no finding that, prior to the transactions giving rise to the assessment under challenge, it constituted trading stock of the appellant. Indeed all the indications from the facts found point to the opposite conclusion.

What is not in doubt is that Mr. Lim Foo Yong

(of whom the Federal Court described the appellant as "the alter ego"), although having a wide range of business interests, is and has been at all material times, a hotel and restaurant proprietor as had the appellant for the major part of its existence. At the date of the hearing before the Special Commissioners he was mainly concerned with the Hotel Merlin Group in Kuala Lumpur, Penang, Cameron Highlands, Hong Kong and with a hotel under construction in Singapore. The Hotel Company was the principal company in that group. He had built the Harlequin Hotel at some time prior to 1950 and had originally managed it himself but subsequently let it to a former employee in return for a rent and a percentage of turnover. There was no suggestion, and no ground for suggesting, that he held the hotel as anything other than a capital investment. It was a small hotel and lacked car parking facilities and servants' quarters and he purchased an adjoining lot (No. 172) and three lots (Nos. 275, 279 and 280) on the opposite side of the road with a view to expanding the hotel site.

These three lots were transferred to the appellant in June 1955. Lot 172 (together with a bungalow on lot 96 which was Mr. Lim Foo Yong's residence) was likewise transferred in September 1955. The Commissioners found as a fact that the plans for expansion of the Harlequin Hotel were abandoned at some time in 1956 when Lim Foo Yong decided to seek an alternative hotel site suitable for a more modern building complex including a swimming pool, conference room and car park. Resolutions of the appellant were passed in February and March 1956 authorising the purchase of five vacant lots and the Special Commissioners found as a fact that they were purchased for the construction of the Merlin Hotel. The appellant then, in 1957, began the construction of the hotel of which, through the Hotel Company, it was, at the date of the hearing, in substance the owner through its shareholding in the Hotel Company and that building was finally completed in 1959. The building was financed by a secured bank overdraft. There was no evidence from which it could properly be inferred that, at this stage, the site and the hotel erected on it were treated as anything other than a capital investment or that they were acquired and developed with a view to re-sale. Indeed the subsequent treatment of the hotel over the next three years points strongly to the opposite conclusion. It was, as has already been mentioned, let immediately on completion to Hotel Merlin Limited, the appellant's wholly owned subsidiary. It was shown in the appellant's accounts as a fixed asset and the rental and management fees charged by the appellant to its subsidiary represented substantially the appellant's only income over the next three years.

The Special Commissioners, with respect to them, appear to have assumed that, since the appellant's objects as appearing from its Memorandum enabled it both to hold investments and also to trade in land and shares, it followed inexorably, if it could be once demonstrated that it had acquired and sold land or shares at a profit, first, that the appellant had for all time and for all purposes to be labelled a company engaged in the business of dealing in property and secondly, that all property of the appellant, for whatever purpose held, necessarily constituted trading stock the profitable disposition of which would give rise to a trading profit. In the Grounds of Decision they observed:–

> "Whether the appellant company had carried on a trade or business with regard to any or all of the above mentioned objects is a question of fact which has fallen upon us to decide. The crux of this case is whether the appellant company had, at all material times, been a company holding property (including rights) or shares as investments in which case the profits arising from realisation or sale thereof would be capital profits, hence not taxable; or whether it had been a company carrying on a trade or business in respect of property (including rights) or shares in which case the profits are of a revenue nature and therefore taxable."

They thus considered the history of Lim Foo Yong's building up of the Harlequin Hotel and his subsequent disposition of the Harlequin land to the appellant, not for the light that it might cast on the particular transactions in question, but for the purpose of seeing whether the way in which the appellant had dealt with that land was consistent with one of the objects of the Memorandum of Association, namely, that of trafficking in land. That was not an irrelevant inquiry because, clearly, whether the appellant had in the past carried on an extension business as a property dealing company was capable of casting some light on subsequent transactions, but it could not, of itself, be determinative of the issue of the nature of the transaction under consideration and to postulate as "the crux of the case" the nature of certain dealings some seven years before the relevant transaction over-states its importance to a degree which, in their Lordships' view, amounts to a misdirection and casts an initial doubt upon the process of reasoning which follows.

What the Commissioners found in fact was that

because the actual site of the Harlequin Hotel had been conveyed to the appellant after the decision had been taken to abandon the process of expansion and because the Harlequin site and the additional lots had been sold in the subsequent year in circumstances in which such profits as were made were treated, apparently without protest, as trading profits, it followed that the appellant was trading or carrying on a business of dealing in property. From that they deduced that every transaction involving any disposition of any property of the appellant which gave rise to a profit must necessarily be a disposition in the course of trading as a property dealing company. In addition, they relied upon the purchase by the appellant from Lim Foo Yong in September 1955 of a shop property and the subsequent sale of that property at a profit in the following April and upon a finding that the appellant had acted as the agent of Peninsular Realty Limited in respect of land transactions. They concluded:–

"The activities of the appellant company show that it was connected with dealing in land. It would be obvious to anyone that the conduct and activities of the appellant company are consistent with that (*sic*) of a company trading or carrying on business of dealing in property. We, therefore, hold that the profit of $2,622,510.00 from the sale of the Merlin Lands and the hotel building by the appellant company to the E.P.F. in 1962 is a trading profit and is accordingly chargeable to tax .. for the same reasons above-stated we hold that the surplus or profit amounting to $4,201,000.00 from the sale of rights to the Hotel Company in 1963 is likewise taxable."

Again, with respect, the Special Commissioners misdirected themselves here. Accepting for the moment the premise that the appellant, whose objects embraced both holding land for investment and dealing in land, had, in the past, entered into transactions which were consistent with the carrying out of the latter objects, it did not follow without further analysis that the Hotel Merlin and the land on which it was built were acquired and held as part of the appellant's trading stock rather than, as every rational indication suggested, as an investment from which the appellant's income was derived. The objects of the appellant included, after all, those of holding land as an investment and carrying on a hotel business. A company may hold both trading stock and capital investments and the mere statement of historical fact that, in the past, certain surplus property has been disposed of at a profit or that some other property has been acquired and disposed of by way of trade cannot legitimately be treated as determinative for all time of the company's intention in acquiring, holding and developing other property.

Turning then to the first of the relevant transactions, the acquisition by the appellant of the hotel land and the erection of the Merlin Hotel has already been described. It should, however, be stressed that there was an express finding of fact by the Special Commissioners that the land was purchased specifically for the construction of the Merlin Hotel. There is no suggestion in the findings that there was any intention at that time to re-sell. Indeed there was a finding that this was an alternative site to take the place of the previous proposal to expand the Harlequin Hotel which had been successfully carried on by Lim Foo Yong for the past six years.

In the course of 1960, following the completion of the hotel, the principal bank loan was discharged out of a sum of $2,000,000.00 lent to the appellant by the E.P.F. on the security of the Merlin lands and it was accepted by the Commissioners that this was to cover the cost of constructing the Merlin Hotel. That loan was paid off out of the proceeds of the sale to the E.P.F. Board in March 1962 in the manner already described. Before the Special Commissioners, it was contended that the transaction with the E.P.F. was a loan, and that was rejected as being inconsistent with the documents and it has not been argued before this Board that the transaction constituted anything but a sale with a lease back to the vendor and a contemporaneous agreement by the vendor to repurchase at the end of ten years at the same price. The Commissioners appear to have accepted that the reason for preferring such an arrangement was that the rental of $371,400.00 to be paid under the lease back was less than the interest which would have to be paid on bank overdraft and that there was the additional advantage that the sum of $5,000,000.00 could not be called in prior to the expiration of the period of ten years. As Mr. Bates has submitted, the arrangement of a sale and lease back is by no means an unusual method of raising money. In this case the contemporaneous repurchase agreement produced substantially the same result as a mortgage and it could hardly be contended that, if this money had been raised by the more conventional but also more expensive method of a mortgage, income tax would be payable on any part of the money raised as a profit from trade.

Before the Special Commissioners it appears to have been considered sufficient that there had been a sale which produced a sum in excess of the acquisition and construction costs of the hotel and their Grounds for Decision contain no analysis of

the effect of the transaction taken as a whole, nor of why or how it could have had the result of causing the hotel, which had been retained and operated for the past three years after its completion and which still continued to be retained and operated, suddenly to take on the character of trading stock. There was in fact no disposition of anything but the bare legal estate in the property. The appellant under the repurchase agreement retained the equitable interest, subject to payment of the purchase price, and remained in possession of the hotel under the lease back.

It seems to their Lordships entirely clear, both from the nature of the transaction taken as a whole and from the Special Commissioners' findings of fact in relation to it, that it was a transaction which was designed to raise finance over a fixed period on a capital asset and their Lordships are unable to agree with the Special Commissioners that the mere fact that it took the form of a sale for a sum which, no doubt, equated with, or was less than, the value of the property but which exceeded the cost of acquisition automatically results in the excess falling to be treated as a taxable profit from trading. The whole tenor of the transaction indicates an intention on the part of the appellant to retain the asset, the hotel and the profit element in it, as a capital asset and to describe finance raised in this way, which in any event was subject to a liability to pay back exactly the same sum on a repurchase, to which the vendor was contractually bound from the inception, as a profit from trade is, in their Lordships' judgment, a misuse of language.

Turning then to the reconstruction, their Lordships cannot help observing at the outset that the finding that this produced a profit from a disposition of trading stock (which is, in effect, what the Special Commissioners found) rather than merely a change in the form of an investment is inconsistent with the Commissioners' own expressed finding in paragraph 5 of their findings of fact which opens with the following words:—

"The hotel business flourished and to keep abreast with modern trend, the idea of further expanding the hotel was formed. This required more capital."

Their Lordships are unable to interpret this as anything but a finding that the purpose of the company reconstruction which the Commissioners then proceeded to describe was anything other than the raising of capital for expansion of the hotel business.

The Hotel Company was formed expressly to take over three groups of assets, that is to say, first, Hotel Merlin Limited and the lease of the building, the nightclub and restaurant business and the Company Harlequin Limited, which was running it as a sublessee of Hotel Merlin Limited; secondly, 92% of the shares of Cameron Highlands Hotel Co. (1959) Limited and the furniture and fittings belonging to the appellant in the hotel (about neither of which does any question arise); and thirdly, the benefit of the 1962 arrangements with E.P.F. The relevant terms of the agreements with the Hotel Company in 1963 have already been described. Was there anything more in this transaction than the transfer by the appellant of a capital investment to a wholly owned subsidiary company which, by being formed as a public company, could carry out what the Commissioners found to be the object of the transaction, namely, the raising of further capital for the expansion of the hotel? Their Lordships are unable to see that there was and find the reasoning both of the Special Commissioners and of the Federal Court difficult to follow. The starting point adopted by both is that because the aggregate nominal value of the new shares in the Hotel Company issued as consideration for the transfer on the reconstruction was equated to the value of the property transferred, it followed that the appellant made a profit of the difference between the original acquisition cost of what was transferred and such aggregate nominal value.

Their Lordships do not quarrel with the proposition that a profit does not have to be realised in cash but can consist of the value of other property including shares. But it is the next step that their Lordships have found difficulty in following, for it seems to have been assumed that, because there was a paper profit, it must necessarily be, to employ the well-known test propounded in *Californian Copper Syndicate* v. *Harris*,[3] "a gain made in an operation of business in carrying out a scheme for profit-making". But so to assume simply from the fact of a profit having arisen begs the question and then one has to look to see what, if any, grounds there were for finding that the reconstruction for the accepted purpose of raising capital for expansion constituted the operation of "a business in carrying out a scheme for profit-making". The two purposes are, in fact, inconsistent. The reasoning of the Special Commissioners, endorsed by the Federal Court, is simply that because the lease (which was subject to a heavy rent which presumably equated with or exceeded market rent and therefore had no value)

was transferred against a nominal consideration of one share, it followed that there must have been an intention to devise and operate a "profit-making scheme" in relation to the other assets. That is the first reason given and it is, with respect, a *non sequitur.* If, as the Special Commissioners suggest, the appellant had transferred its valuable assets for one share, the "profit" would equally have been there, for the appellant would then have owned one share of enormous value and the excess in the value of the assets transferred over the nominal value of the one share issued as consideration would have had to be carried to a share premium account. It is difficult to see how the mere fact that shares are issued at par and not at a discount can be any indication of an intention to engage in a profit-making scheme. The second reason given by the Special Commissioners is equally difficult to follow. It is this:–

"Moreover, the sale of rights is indicative of the fact that the appellant company had completely divested itself of any interest whatsoever in the Merlin lands and the hotel buildings."

That seems to be saying no more than this, that because there has been a sale and transfer, it follows that the sale and the transfer is in the operation of a business of carrying out a scheme of "profit-making", which merely repeats the fallacy that the profit is by itself and of itself necessarily a "scheme for profit-making". It is, of course, true that the appellant had divested itself of its direct interest in the land and hotel. So does any company which transfers property to a subsidiary in return for shares.

The Commissioners quite rightly observed that a number of authorities (see, for instance, *Craddock* v. *Zevo Finance Company Limited*[4] and *The Royal Insurance Company Limited* v. *Stephen*[5]) established that an exchange of securities in a reconstruction constitutes a realisation of the property exchanged, but they seem to have assumed that it follows from this that any profit element arising from the fact that the new shares exceed the acquisition cost of the property exchanged is *per se* taxable. In fact, of course, the transferring company retains an interest in the property exchanged through its shareholding in the new company and the transformation of a direct property interest into a shareholding tells one nothing about whether the transaction is a trading transaction or merely a change of investment. The Special Commissioners appear to have concluded not only that the reconstruction *per se* demonstrated that the appellant was realising the assets exchanged (or some of them) by way of a disposition of trading stock but also that, contrary to the finding that the purpose was to raise capital for expansion, the fact that the Hotel Company subsequently obtained a quotation was evidence also that the appellant conceived what they described as a "scheme of profiteering in shares". Their Lordships are unable to see how this could properly be treated as probative of any such scheme. Of course the purpose of forming a public company was to issue shares to the public and thus raise capital in order to enable the hotel to expand, as the Commissioners had found, but that is not "profiteering in shares".

As regards, therefore, the sums of $4,201,000.00 represented by the value of the repurchase agreement and the $494,000.00 representing the profit on the exchange of the appellant's holdings in Harlequin Limited and Hotel Merlin Limited (to which exactly the same considerations apply) the conclusion at which the Special Commissioners arrived was both inconsistent with their own finding as to the purpose for which the transaction was entered into and unsupported by evidence of any probative value that what had clearly started out as a capital asset had somehow become trading stock which was disposed of by the appellant in the course of carrying on either a business of dealing in land or "the business of carrying out a profit-making scheme".

The final transaction giving rise to a profit of $288,332.00 was the sale by the appellant of 1,481,000 shares in the Hotel Company to friends and associates of Lim Foo Yong. The vast bulk of the shares issued on the reconstruction, that is 5,099,782 shares, were retained by the appellant and on the face of it the sale of a minority holding arising from the disposition of a capital asset in the form of shares in a subsidiary company appears as no more than itself the disposition of a substituted capital asset. The basis for the Special Commissioners' finding that profit made on the sale of these shares was a trading profit is not entirely clear from their Grounds of Decision. It seems to have stemmed from the conclusion that, because the Hotel Company had gone public and achieved a quotation, this in itself demonstrated that the appellant had conceived a "scheme of profiteering in shares" – a conclusion which, as already mentioned, did not follow from the premise and was in any event inconsistent with the finding as regards the purpose of the reconstruction – and possibly, though this is by no means clear, from certain previous transactions in shares from which the Commissioners may have drawn an inference

(although they did not expressly say so) that the company was carrying on a business of dealing in shares. They cited "for the sake of completeness" four "activities connected with share transactions". The first was a disposition in 1961 of a small number of shares in a company called Ban Guan Limited to an individual, apparently for services rendered. The second was the liquidation in 1962 of a company formed to develop land whose property was compulsorily acquired. There was no finding that any profit arose on either transaction. The third was a holding of shares in a banking corporation which the Commissioners found was clearly for purposes of investment; and the fourth was the exchange of the shares in the Cameron Highlands Hotel Company in the reconstruction. If and so far as the Special Commissioners relied upon these facts as giving rise to any inference either as to the nature of the disposition of the shares in the Hotel Company or as to the carrying out of "a profit-making scheme" their Lordships are unable to see that they had any probative value at all.

Finally, the Special Commissioners relied upon two features of the company's accounts as supporting their conclusions. The first was that the expenses relating to building the Merlin Hotel were said to have been "charged to revenue account". If by this it is meant that interest and bank charges and the rent paid to the E.P.F. were shown in the profit and loss account, that is exactly what one would expect whether the asset was to be treated as a capital investment or as trading stock. Their Lordships are, in any event, unable to detect any significance in this. It is equally true that the Hotel Merlin and its site were shown in the accounts as fixed assets and the Federal Court, in its judgment, appears to have treated the two considerations as cancelling one another out. The second was that, in the accounts for the years 1961 and 1962, the surplus on sales of properties was shown in the balance sheet as such and was not labelled "capital reserves". This is a pure point of semantics and nothing, in their Lordships' view, can be made to turn on it.

Broadly the judgment of the Federal Court simply follows and adopts the reasoning of the Special Commissioners. The Court rightly said that it could not exercise an original jurisdiction on matters of fact. The basis for their decision to uphold the Special Commissioners is to be found in the following passage from the judgment:—

"The land dealings are clearly authorised and contemplated by Clause 3(2) of the respondent's Memorandum of Association as trafficking in land.

Thus having regard to the objects of the respondent, and what it did with respect to lands it acquired from Mr. Lim Foo Yong and what it did with regard to Hotel Merlin and its lands, we are satisfied that there is evidence to justify the finding by the Special Commissioners that the respondent was carrying on a business of land dealing and that the surpluses obtained therefrom were gain derived from such business."

Their Lordships have felt unable to agree with this, having regard to the reasoning upon which the decision of the Special Commissioners was based and to the inconsistencies in their findings. There was, in their Lordships' view, no evidence of probative value upon which the Commissioners could legitimately conclude that the transactions giving rise to the additional assessments were other than the realisation of capital assets. The conclusion reached was based upon fallacious reasoning and was, in any event, inconsistent with their own findings as to the purpose of the disposition. Their Lordships had very much in mind Mr. Potter's forceful submission that the statute places on the appellant the burden of demonstrating that the assessments were erroneous and that there was no express finding by the Commissioners that the hotel land was acquired and held as a capital asset nor any evidence that the appellant had expressly so resolved. That may be so, but the burden is no higher than that in any other civil proceeding and the facts found relating to the acquisition, development and holding of the hotel lands do not, in their Lordships' judgment, admit of any other reasonable conclusion than that they were acquired and held as capital assets. The Special Commissioners are, of course, as the Federal Court rightly observed, the judges of fact, but in finding the facts and drawing inferences of secondary fact from them, they must not misdirect themselves and they must draw conclusions from facts having probative value. In their Lordships' judgment, the Special Commissioners in this case both misdirected themselves by reaching conclusions inconsistent with primary facts found by them and drew inferences from matters which were of no probative value in supporting their conclusions.

Their Lordships will, accordingly, advise His Majesty the Yang di-Pertuan Agong that the appeal should be allowed, that the order of Harun J. in the High Court should be restored, and that the respondent should pay the appellant's costs before the Federal Court and in respect of this appeal.

Appeal allowed.

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